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LAYERING, CONVERSION, AND DRIFTING: A  
COMPARATIVE ANALYSIS OF PATH DEPENDENT CHANGE IN  
CONSUMER INSOLVENCY SYSTEMS

MEGAN McDERMOTT\*

INTRODUCTION

The design of a country's consumer insolvency system involves innumerable policy choices that broadly reflect the social and economic context in which the legislation has been introduced.<sup>1</sup> Differences among countries can be observed and compared across many different but interrelated metrics, including substance,<sup>2</sup> rates of usage,<sup>3</sup> and decisions regarding implementation.<sup>4</sup>

Differences in substance are in some ways easiest to discern and measure. For example, a country must decide whether to make a discharge available, and if so, whether its availability should be limited to certain debtors or dependent on a showing of a diligent effort to pay.<sup>5</sup> Likewise, a country must decide whether to impose broad constraints on the system, such as exempting

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1. See Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT'L & COMP. L. REV. 1, 4 (2005) ("Insolvency systems profoundly reflect the legal, historical, political, and cultural context of the countries that have developed them.").

2. See, e.g., JACOB S. ZIEGEL, *COMPARATIVE CONSUMER INSOLVENCY REGIMES—A CANADIAN PERSPECTIVE* 9 (2003) (identifying the various substantive metrics for his comparative study of consumer insolvency laws, including debtor exemptions, payment of past and future wages, conditions for a discharge, and prerequisites for entering insolvency proceedings).

3. See, e.g., Ronald J. Mann, *Making Sense of Nation-Level Bankruptcy Filing Rates*, in *CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES* 225, 227 (Johanna Niemi et al. eds., 2009).

4. See, e.g., Iain Ramsay, *Comparative Consumer Bankruptcy*, 2007 U. ILL. L. REV. 241, 263–64 (linking the economic incentives created for lawyers and private professionals to increased rates of filing).

5. See, e.g., Jason Kilborn, *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice*, in *CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES*, *supra* note 3, at 307, 315 (explaining that European insolvency laws have historically "arranged themselves on a continuum" between narrow relief that only allows debt modification and broader relief that may include a discharge).

certain debtor assets from liquidation or excepting certain debts from discharge.<sup>6</sup>

Rates of usage are also fairly easy to measure, though complicated by the fact that several systems offer multiple options for consumers.<sup>7</sup> A country's optimal degree of usage directly influences design choices.<sup>8</sup> Countries that seek to expand the rates of use may make design choices that streamline the process or make it more desirable for consumers.<sup>9</sup> On the other hand, a system that is too popular may disrupt the fragile balance between creditors and debtors and may be scaled back to make it less desirable for consumers.<sup>10</sup>

The third metric, implementation, is the most challenging for comparative insolvency scholars to evaluate. On the surface, differences in implementation are deceptively easy to observe and measure. For example, it is quite simple to divide countries between those that rely on a court-based system<sup>11</sup> versus those that employ a more administrative system.<sup>12</sup> However, in some ways, these implementation differences are merely superficial and mask more difficult questions that connect closely to design choices. For example, the design of an insolvency system also requires choices regarding

6. See, e.g., ZIEGEL, *supra* note 2, at 9 (identifying the many decisions a country must make about the nature and scope of its discharge).

7. See, e.g., Ramsay, *supra* note 4, at 260–62 (arguing that statistics regarding usage can be misleading if they don't adequately account for all mechanisms a country offers for addressing overindebtedness). In addition, Professor Ramsay argues that the raw data do not tell the full story, because some countries' insolvency systems are designed for use primarily by middle class debtors (e.g., the U.S. and Japan), while others are designed to provide relief for lower income debtors (e.g., Canada and the United Kingdom). *Id.* at 261–62.

8. See, e.g., Johanna Niemi, *Overindebted Households and Law: Prevention and Rehabilitation in Europe*, in CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES, *supra* note 3, at 91, 102–03 (explaining that many countries have imposed disincentives to filing bankruptcy which may reflect cultural attitudes toward debt but may also create unnecessary hurdles for consumers who need debt relief); see also Mann, *supra* note 3, at 227 (explaining that rising levels of insolvency internationally have triggered numerous debates about the optimal level of usage by consumers). Professor Mann further notes that, like most programs that have a social welfare component, legislators have a long tradition of designing the program in ways that stigmatize its use. *Id.* at 230.

9. See Mann, *supra* note 3, at 227 (noting that the United Kingdom and Japan have both introduced recent reforms to better incentivize consumer use). However, Mann questions whether economic incentives are sufficient to overcome cultural barriers. See *id.* at 228–31.

10. See *id.* at 227 (noting that the United States responded to rising numbers of consumer filings by limiting access).

11. The United States is a prominent example of a court-based system. See Angela Littwin, *The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for its Surprising Success*, 52 WM. & MARY L. REV. 1933, 1938–39 (2011) (noting that the court system used by the United States stands in contrast to its main social welfare programs, which are handled administratively).

12. France is a prominent example of a system that is largely administrative, with limited court involvement. See, e.g., Jason J. Kilborn, *La Responsabilisation de L'Economie: What the United States Can Learn from the New French Law on Consumer Overindebtedness*, 26 MICH. J. INT'L L. 619, 635–45 (2005) (describing the prominent role that France's regional commissions play in implementing consumer insolvency law as compared to the more limited role of courts).

the degree of predictability and uniformity in applying its substantive provisions.<sup>13</sup> Should a country implement its policy choices via bright-line rules? Or should a country use more flexible standards and allow the system to dispense justice in individual cases? Such choices are key to implementation but are not always easy to measure in ways that allow meaningful comparisons among countries.

Another deceptively simple basis for comparison is to distinguish those countries whose systems are designed for use by private practitioners (such as the United States,<sup>14</sup> Scotland,<sup>15</sup> and Japan,<sup>16</sup> which rely on lawyers, or Canada,<sup>17</sup> which relies on accounting professionals) and those systems in which debtors do not need private representation, such as Germany,<sup>18</sup> France,<sup>19</sup> and the Netherlands.<sup>20</sup> However, this distinction may be misleading, because many of the countries in which private professionals are unnecessary rely instead on public or not-for-profit institutions that play a powerful gatekeeping role that is equal to, if not more entrenched than, that of private professionals.<sup>21</sup>

Because of the deeper layers of analysis that arise with implementation questions, the differences among various countries' institutional frameworks for implementation are arguably the most complicated to evaluate.<sup>22</sup> Yet it is a critical inquiry to understanding design choices. This is because many insolvency systems are designed either with input from, or in reaction to, the professionals and institutions tasked with implementation.<sup>23</sup>

13. For example, the Netherlands and France have both shifted from a discretionary system to more bureaucratic bright line rules. *See infra* Section I.A.

14. *See infra* Section I.B.2.

15. *See infra* Section I.B.1.

16. *See infra* Section I.C.2.

17. *See generally* ZIEGEL, *supra* note 2, at 28–30, 155–56 (describing the critical role of the trustee, who is a private professional hired and paid by the debtor).

18. *See infra* Section I.C.1.

19. *See infra* Section I.A.1.

20. *See infra* Section I.A.2.

21. *See* Iain Ramsay, *U.S. Exceptionalism, Historical Institutionalism, and the Comparative Study of Consumer Bankruptcy Law*, 87 TEMP. L. REV. 947, 953 (2015) (explaining that a central notion of path dependency is that once institutions are given central responsibility for implementing policy, the operation of these institutions becomes more significant than the initial design choices).

22. *See id.* at 951 (“A salient characteristic of consumer insolvency institutions is that they rarely emerge fully formed but often develop over time and may involve a process of conversion of existing institutions. . . . Identifying and explaining change in bankruptcy law are not simple tasks.”).

23. *See, e.g.,* Ramsay, *supra* note 4, at 264 (noting that professionals may have a “disproportionate influence on the structure and substance of” insolvency law due to its “technical nature”); *see also id.* at 271 (concluding that “[p]ro-debtor laws in a country may . . . be a side wind” of the professionals tasked with implementing the laws).

In a recent article, Professor Iain Ramsay proposed using the lens of historical institutionalism, which focuses on the mechanisms of legal stability and change, to examine consumer insolvency systems.<sup>24</sup> Professor Ramsay shows that the tools of historical institutionalism yield valuable insights about the law in action and the institutional forces that shape legal change.<sup>25</sup> In particular, the concept of path dependency offers a useful framework for analyzing consumer insolvency systems.<sup>26</sup> Path dependency starts from the proposition that, in the absence of some motivating force for change, policies will remain stable.<sup>27</sup> Changes occur at “critical junctures,” when circumstances create opportunities for reform.<sup>28</sup>

Importantly, historical institutionalism recognizes that the changes that yield the most useful insights are not always dramatic changes.<sup>29</sup> For example, there may be periods when there is little appetite for political change, and other moments when the political costs of major change may be too high.<sup>30</sup> Instead, many smaller changes occur more subtly through the processes of layering, conversion, or drifting.<sup>31</sup> Layering occurs when rules or policies are added to an existing legal framework.<sup>32</sup> Conversion occurs when institutional actors take advantage of opportunities to exploit ambiguities in the existing legal framework.<sup>33</sup> Drifting occurs when an unaddressed gap emerges between design and implementation.<sup>34</sup> Importantly, drifting can be the result of legislative inadvertence or an intentional design feature.<sup>35</sup> Professor Ramsay argues that these three categories can bring new lucidity to comparative studies of consumer insolvency systems.<sup>36</sup> As an example, he offers a comprehensive overview of the English insolvency system through the lens of drifting and conversion.<sup>37</sup>

24. Ramsay, *supra* note 21, at 948, 952. Professor Ramsay has since incorporated these ideas into a broader comparative study of the United States, England and Wales, France, and Sweden. See IAIN RAMSAY, PERSONAL INSOLVENCY IN THE 21ST CENTURY: A COMPARATIVE ANALYSIS OF THE US AND EUROPE 14–15 (2017).

25. Ramsay, *supra* note 21, at 948–52.

26. *Id.* at 954–55.

27. *Id.*

28. *Id.* at 955. For consumer insolvency, the changes that create reform opportunities include major political shifts, economic downturns, or puzzles arising from unexpected rates of usage. *Id.*

29. *Id.* at 955–56.

30. *Id.* at 956.

31. *Id.* at 955–57.

32. *Id.* at 956.

33. *Id.*

34. *Id.* at 955–56.

35. *Id.* at 956.

36. *Id.* at 955–56.

37. *Id.* at 965–72.

Drawing in part on the framework proposed by Professor Ramsay, this Article identifies and examines changes in the consumer insolvency systems in seven different countries. The analysis does not purport to be a complete explanation of the economic, cultural, and political forces contributing to the change or stability of each system. Instead, the analysis is narrow and focuses on three questions. First, to what extent did the professionals or institutions tasked with implementing the systems play a role in motivating those changes? Second, are the changes on balance pro-consumer or anti-consumer? Third, to what extent does the general legal climate of a particular country influence the design and implementation of each system?

Importantly, this Article remains neutral on the many questions surrounding the optimal design and use of particular systems, and instead focuses on questions relating to the path-dependence of the recent changes that can be observed in each system.<sup>38</sup> Accordingly, this Article starts from the premise that each country has valid cultural and economic reasons for its initial choices regarding the design and use of its insolvency system.<sup>39</sup> By starting from this premise and then looking at the shifts that each system has undergone over time, we can see a trajectory that sheds light on the degree to which the implementation of the system may have either strayed from these initial choices, or created outcomes that raise questions about the wisdom of these initial choices. We can then try to connect these trajectories to the professionals and institutions that are tasked with implementation.

Having identified these path dependent trajectories, we can then use existing metrics to evaluate the trends in order to determine how the presence or absence of institutional change agents may be reshaping the law. One common metric for evaluation in comparative consumer insolvency is whether an insolvency system is pro-consumer or anti-consumer. These labels capture scholars' sense of whether an insolvency system offers meaningful relief to consumers. But, as others have argued, these labels are necessarily reductive and cannot convey the degree to which the availability of meaningful relief is influenced by cultural attitudes toward debt or other political obstacles.<sup>40</sup> Nonetheless, evaluating whether the trends are pro-consumer or anti-consumer can yield valuable insights about how institutional

38. See Ramsay, *supra* note 4, at 258 (encouraging comparative consumer insolvency scholars to move beyond descriptions and noting trends and instead made broader and more generalized inquiries into the institutional forces that shape insolvency laws in various countries).

39. See *id.* at 256 (“[B]ankruptcy law is at the crossroads of important values—the legal and social norm that debts should be repaid and the value of a safety net for individuals who have miscalculated risks or suffered from an important change of circumstances.”).

40. See, e.g., Iain Ramsay, *Interest Groups and the Politics of Consumer Bankruptcy Reform in Canada*, 53 U. TORONTO L.J. 379, 379 (2003) (noting that asking whether a system is “‘creditor-friendly’

change agents may be reshaping insolvency systems in ways that could not be accomplished solely through the political process.

Another common metric for evaluation is whether a country's bankruptcy system is "efficient." However, "efficiency" can be measured from many different perspectives and may often be in the eye of the beholder. One narrower approach to assessing a system's efficiency uses the concept of rational sorting.<sup>41</sup> Professor Jean Braucher describes rational sorting as "a principle to reconcile to the greatest extent possible . . . three goals . . . creditor repayment at lowest administrative cost, debtor discharge and treatment."<sup>42</sup> Many insolvency systems engage in "sorting" in that they are designed to channel debtors into different options based on their repayment abilities. However, irrational sorting occurs when debtors with different repayment abilities are sorted into the same channels.<sup>43</sup> On the other hand, even if the system properly sorts consumers into appropriate channels, the system may be inefficient if the administrative costs or delays created by the sorting mechanism exceed the benefit to creditors. The various insolvency systems are all over the map, literally and figuratively, when it comes to the sorting mechanisms they employ. However, determining whether a country is trending toward rational sorting may provide helpful insights about how countries can achieve that particular component of efficiency, regardless of where they started.

This Article proceeds as follows. Section I identifies seven countries that have experienced significant consumer insolvency developments over the last two decades and uses these developments to suggest three general categories for evaluating the role of professionals and institutions in shaping the implementation of consumer bankruptcy systems. Section II summarizes the key aspects of this analysis and identifies several patterns that emerge under the lens of historical institutionalism.

or 'debtor-friendly' . . . obscures the central part that other interest groups play in the development of the law").

41. See, e.g., Jean Braucher, *A Law-in-Action Approach to Comparative Study of Repayment Forms of Consumer Bankruptcy*, in CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES, *supra* note 3, at 331, 347-48.

42. See *id.* at 347.

43. See *id.* at 348.

## I. IDENTIFYING PATH DEPENDENT CHANGE

This Section builds on Professor Ramsay's initial "sketch"<sup>44</sup> by analyzing recent changes in consumer insolvency systems using the tools of historical institutionalism.<sup>45</sup> Specifically, I draw on the work of several international insolvency scholars to identify seven examples of systems that have been redesigned at various points in the last two decades in order to adjust to implementation issues. In most cases, the implementation by key professionals or institutions did not align fully with the desired outcomes under the law. Accordingly, the law on the books often needed to be reformed to adapt to the unanticipated implementation issues. As will be shown, some countries have been more proactive than others in responding to this need.

Part A discusses two examples of countries, France and the Netherlands, in which path-dependent reforms to avoid drifting have reduced irrational sorting among debtors and have resulted in improved outcomes for consumers. Part B discusses three examples of countries that have experienced conversion—Scotland, the United States, and Canada—leading to results that are less consumer-friendly and less rational in their sorting than their initial baseline. Part C discusses two examples of countries that have enacted pro-consumers reforms but have also experienced some degree of drifting, Germany and Japan.

### *A. Countries Where Changes Have Improved Rational Sorting and Consumer Outcomes*

#### 1. France

France is the first example of a country that has addressed the disconnect between design and implementation of its insolvency system in pro-consumer ways.<sup>46</sup> France's main institutional actors are the government-created commissions that have been tasked with a gatekeeping role in consumer

44. See Ramsay, *supra* note 21, at 974. Professor Ramsay's article included an in-depth examination of the English insolvency system, which this article will not seek to revisit or expand upon. *Id.* at 965–72.

45. In particular, this project focuses on the patterns leading to the most significant consumer insolvency reforms of the 2000s, which was an "especially robust and dynamic" decade for developments in consumer insolvency. See Jason J. Kilborn, *Still Chasing Chimeras but Finally Slaying Some Dragons in the Quest for Consumer Bankruptcy Reform*, 25 LOY. CONSUMER L. REV. 1, 1 (2012). However, this Article does not purport to be a complete survey of every development, nor does it purport to present the most up-to-date information about any particular country.

46. See Ramsay, *supra* note 4, at 250 (pointing to France as the prime example of the "gradual liberalization" of insolvency law in Europe over the last decade); see also Kilborn, *supra* note 45, at 2–3



bankruptcy and, to a lesser extent, its Cour de Cassation, which is France's highest appellate court for civil legal issues. Overall, the French insolvency system is seen as a success in terms of its rate of use among French consumers.<sup>47</sup> Nonetheless, there have been regular amendments as the legislature has tried to proactively address the many gaps between policy and implementation.<sup>48</sup>

Prior to 1990, French debt relief had focused on businesses and offered few avenues for consumers.<sup>49</sup> However, that changed with the enactment of France's so-called *loi Neiertz*, which became effective in 1990.<sup>50</sup> Under the *loi Neiertz*, the main route for consumer relief in France is a payment plan that is prepared and overseen by administrative commissions working under the auspices of the Bank of France.<sup>51</sup>

The French process was heavily utilized when it was initially implemented.<sup>52</sup> Initially, debtors could proceed straight to court.<sup>53</sup> But France's courts were overwhelmed with the number of filings, which led to significant delay in relief.<sup>54</sup> In response, the legislature amended the law to have the commissions play more of a gatekeeping role.<sup>55</sup> Judges retained discretion to determine whether to grant a discharge.<sup>56</sup>

A representative of the Bank of France does most of the work of the commission, including collecting information from the debtor, recommending a payment plan, and then negotiating with creditors.<sup>57</sup> If creditors accept

(pointing to France's insolvency reforms in the 2000s as the lead example of a country that has dealt effectively with "the twin monsters of inefficiency and waste").

47. See Jason J. Kilborn, *The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the New U.S. Law from Unexpected Parallels in the Netherlands*, 39 VAND. J. TRANSNAT'L L. 77, 108 (2006) (noting that France had twenty-seven filings per 10,000 residents in 2004, low compared to the United States' fifty-five per 10,000, but high compared to the Netherlands and Belgium, which each have fewer than ten per 10,000).

48. See Kilborn, *supra* note 12, at 661.

49. See *id.* at 627; see also Niemi, *supra* note 8, at 100 (explaining that France introduced a discharge for businesses in 1985 but did not add a consumer discharge until 2003).

50. See Kilborn, *supra* note 12, at 635.

51. See ZIEGEL, *supra* note 2, at 140; see also Kilborn, *supra* note 12, at 637–38 (describing the membership of each commission, which includes a social worker, a lawyer, and a representative of the French central bank).

52. See ZIEGEL, *supra* note 2, at 140 (noting that 90,000 applications were filed in the first ten months).

53. Kilborn, *supra* note 12, at 645.

54. *Id.*; see also RAMSAY, *supra* note 24, at 123 (explaining that the French Ministry of Justice sought to divert insolvencies from the "chronically underfunded" court system). Ramsay further notes that the courts played an early and significant role in liberalizing bankruptcy relief and pushing for greater uniformity. *Id.* at 125–28.

55. See Kilborn, *supra* note 12, at 645–46.

56. See Martin, *supra* note 1, at 42.

57. Kilborn, *supra* note 12, at 638.

the plan, it is a self-executing process; if creditors resist, then the commission can seek court assistance.<sup>58</sup>

However, the great discretion given to the commission created lasting problems for the French system.<sup>59</sup> The early plans frequently failed, due in part to the fact that, at eight to ten years, they were overly long.<sup>60</sup> Many plans also left consumers with a “hyper-frugal budget[ ]” that left them unable to pay for basic living expenses.<sup>61</sup> As a result of these unappealing prospects for relief, the number of filings leveled off for several years but rose again in the late 1990s,<sup>62</sup> around the time when France’s economic minister stepped in to encourage the commissions to be less stingy with debtors.<sup>63</sup>

Legal reform occurred in 1998, when the legislature added new protections for debtor earnings.<sup>64</sup> The 1998 reforms also added a safety valve for those debtors who are clearly unequipped to make use of the option of a negotiated payment plan: in such “extraordinary” cases, debtors could take advantage of a long-term deferment, at which point they become eligible for a partial discharge if they are still unable to make payments.<sup>65</sup> These extraordinary cases accounted for around ten percent of the debtors who apply to the commission, and only a small percentage of those cases are ultimately recommended for discharge.<sup>66</sup>

Despite these incremental changes, the system still left many consumers without timely and effective relief.<sup>67</sup> In addition, the system suffered from a lack of uniformity because the 117 commissions across the country varied widely in terms of the relief they were willing to recommend for consumers.<sup>68</sup> Accordingly, in 2003, the law was amended yet again to provide more streamlined relief to consumers, similar to the relief that had long been available for French businesses.<sup>69</sup> This discharge is available to those debtors who

58. See ZIEGEL, *supra* note 2, at 140.

59. See Kilborn, *supra* note 5, at 316.

60. See Kilborn *supra* note 12, at 641.

61. See *id.* at 643.

62. See ZIEGEL, *supra* note 2, at 140 (noting a substantial drop-off in filings between 1991 and 1994).

63. See Kilborn *supra* note 12, at 643–44.

64. *Id.* at 644.

65. See *id.* at 650–51. The original deferment period was three years, but it was reduced to two years in 2004. See Kilborn, *supra* note 45, at 26.

66. Kilborn, *supra* note 12, at 654.

67. *Id.* at 655. Professor Kilborn cites a 2001 study showing that twenty-seven percent of French consumers were unable to repay their debts, while only a small fraction were able to get relief.

68. See *id.* at 636, 664.

69. *Id.* at 655–56. Kilborn notes that this process is “virtually identical” to Chapter 7 in the United States. *Id.* at 656.

the commission determines are “irremediably compromised.”<sup>70</sup> The commission then directs the matter to the court, at which point the judge, perhaps with help from a court-appointed trustee, verifies the debtor’s condition and then, if warranted, grants a broad discharge known as a “personal recovery.”<sup>71</sup>

As with past changes, which proved ineffective, these new procedures were not immediately successful either.<sup>72</sup> Wide disparities remained among the various commissions and the relief they were willing to recommend.<sup>73</sup> However, over time, the commissions warmed to the prospect of recommending larger numbers of consumer cases for the streamlined discharge process.<sup>74</sup> The numbers of filers increased dramatically, prompting an additional set of streamlining measures in 2011.<sup>75</sup>

This series of changes appears to be a cautious effort at reform in the face of overwhelming French skepticism about lenient debt laws.<sup>76</sup> Nonetheless, the end result is quite debtor friendly, as France has “moved more decisively to expand and refine relief.”<sup>77</sup> France stands out as an example of a country in which the political costs of discharge may have been too high initially.<sup>78</sup> However, by choosing a bureaucratic system dominated by technocrats, France created a path in which the law could be gradually adjusted in pragmatic ways to expand relief to consumers.<sup>79</sup>

These changes have been influenced to a large degree by the presence of a strong institutional actor: the Bank of France.<sup>80</sup> Initially, the Bank was reluctant to play a leading role in consumer insolvency, but ultimately agreed to be involved in the commissions under the belief that the insolvency measures would only be temporary.<sup>81</sup> However, its institutional role was quickly cemented, which in turn impacted (and perhaps even undermined) the government’s ability to deliver effective relief to debtors.<sup>82</sup>

70. *Id.* at 658.

71. *See id.* at 658–60.

72. *See id.* at 660–61.

73. *Id.* at 664.

74. *See* Kilborn, *supra* note 45, at 27 (noting that the percentage of recommendations increased from twelve percent in 2004 and 2005, to twenty percent in 2007 and 2008, and to more than thirty percent in 2009 and beyond).

75. *See id.* at 27–28.

76. *See* Martin, *supra* note 1, at 44.

77. *See* Kilborn, *supra* note 45, at 28.

78. *See* Ramsay, *supra* note 21, at 972–73.

79. *See id.* at 973.

80. *See, e.g.,* Kilborn, *supra* note 5, at 316 (describing the Bank of France as the “secret weapon” behind the success of the French system).

81. *See* Ramsay, *supra* note 21, at 953.

82. *See id.* at 953–54.

Importantly, the changes detailed above were largely reactive. After the legislature made the choice to place the powerful Bank of France at the center of its system, decisions from France's Cour de Cassation attempted to forge a more consistently liberal approach to relief.<sup>83</sup> Additional legal reforms sought ways to scale back the discretion that the Bank-led commissions were exercising, while expanding meaningful relief to more consumers.<sup>84</sup> By using the commissions as gatekeepers but also constraining their discretion, France appears to have made great progress toward rational sorting. Applying the lens of historical institutionalism, we can see that the legislature acted repeatedly to avoid drifting and to proactively close gaps between design and implementation.

Because the French system is "more bureaucratic than legal in character,"<sup>85</sup> the system provides no real opportunity for lawyers or other private professionals to play a role in obtaining relief for debtor clients.<sup>86</sup> But even though it is largely non-legal, France's insolvency system shares common ground with its civil justice system, which is one of the cheapest and simplest in the world.<sup>87</sup> In designing and reforming the French civil justice system, French lawmakers have consistently strived for efficiency and ease of use, with a particular eye to reducing the burdens faced by courts.<sup>88</sup> Thus, it is not surprising that the French insolvency system has demonstrated a similar commitment to efficiency (by reducing irrational sorting), ease of use, and a bureaucracy that largely manages the process with limited need for court involvement.

## 2. The Netherlands

The Netherlands is the second example of a country that has acted in largely pro-consumer ways to address distorting effects from the institutions tasked with implementation. The Netherlands' main institutional actors in consumer insolvency have historically been its debt counselling services.

83. See RAMSAY, *supra* note 24, at 126–28 (explaining how France's Cour de Cassation, which focuses on legal issues, helped improve consistency).

84. See Kilborn, *supra* note 5, at 322. Kilborn notes that in recent years, the commissions have exercised their discretion in ways that are markedly more consumer-friendly, which suggests that the commissions have become more responsive to the political pressures they face as gatekeepers. *Id.* at 324.

85. See Niemi, *supra* note 8, at 102.

86. The one exception appears to be the lawyer on each commission who is tasked with determining the legal validity of creditor claims and ensuring that the commission's court filings are legally adequate. See Kilborn, *supra* note 12, at 637.

87. See Daniel Soulez Larivière, *Overview of the Problems of French Civil Procedure*, 45 AM. J. COMP. L. 737, 738–39 (1997).

88. *Id.* at 737.

These municipally funded agencies have been at the center of Dutch consumer life for decades, initially providing consumer banking services and later repurposing themselves to provide free or low-cost debt negotiation services for consumers.<sup>89</sup> However, we see a critical juncture in the Netherlands in the 1990s, which led to the addition of the court system as an institutional actor in 1998. The purpose of this change was to strengthen the role of debt counselling services in obtaining voluntary settlements.<sup>90</sup> Following this change, gaps soon emerged between design and implementation, which in turn required significant revisions to the law. Over the long term, however, these reforms have helped to simplify the process and address irrational sorting.<sup>91</sup>

The main path to consumer debt relief in the Netherlands was historically through credit counseling and voluntary payment plans.<sup>92</sup> However, in the 1990s, concerns arose over the increase in the number of consumers seeking relief coupled with a decline in the number of successful payment plans.<sup>93</sup> In essence, too many consumers lacked viable debt relief. Accordingly, the legislature stepped in to design a more consumer-friendly regime that incorporated the possibility of a discharge and fresh start.<sup>94</sup> The result was 1998's *Wet schuldsanering natuurlijke personen* or WSNP, which translates to "Law on Debt Rehabilitation of Natural Persons."<sup>95</sup>

The new law had three goals: promote amicable debt settlement by creating creditor incentives to settle, reduce the overall number of bankruptcies, and provide a fresh start to debtors whose creditors were unwilling to settle.<sup>96</sup> Among other objectives, the legislature hoped that strengthening debtors' hand in the debt settlement process would reduce their need to resort to the courts, thereby facilitating a more cost-effective method of reducing over-indebtedness.<sup>97</sup> But the incentives created by WSNP actually had the opposite effect: debt settlement rates started out very high (around forty percent)

89. See Kilborn, *supra* note 47, at 88.

90. See Kilborn, *supra* note 45, at 15.

91. See *id.* at 13 (noting that 2008 reforms "have begun to slay a real dragon by avoiding wasteful, superfluous administrative complexity").

92. See Kilborn, *supra* note 47, at 87–88.

93. See *id.* at 91. This increase, and the resulting push for a political solution, may have been driven by a reform in the late 1980s that allowed creditors to collect debts from government benefits in the same manner that they could collect from wages. See Nadja Jungmann & Nick Huls, *Debt Counselling in the Shadow of the Court: The Dutch Experience*, in CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES, *supra* note 3, at 419, 423.

94. See Kilborn, *supra* note 47, at 92–93.

95. *Id.*

96. See Jungmann & Huls, *supra* note 93, at 419.

97. See *id.* at 420.

but dropped dramatically over the years and were hovering at around ten percent by 2004.<sup>98</sup>

Under the new law, consumers were still required to go through credit counseling to try to produce a voluntary repayment plan.<sup>99</sup> Though plans may vary in their design, most debt counseling organizations adhered to a “Code of Conduct,” which helped to standardize the plans.<sup>100</sup> Under the Code of Conduct, a plan lasts three years, treats creditors equally, leaves debtors with a “social minimum” after payment, and gives the debtor a discharge at the end of three years.<sup>101</sup>

If this process proved unsuccessful, WSNP allowed consumers to apply to court for relief.<sup>102</sup> An appointed trustee oversees the liquidation of assets and devises a multi-year payment plan paid through the debtor’s future income.<sup>103</sup> The payment plan is typically three years, but courts are given considerable discretion in deciding whether to extend it to five years.<sup>104</sup> After the payment period, the debtor is eligible for a discharge unless the court finds a reason to deny it. In practice, the denial of a discharge is exceedingly rare.<sup>105</sup>

These processes were quickly standardized, thanks in large part to a working group of Dutch bankruptcy judges called Recofa.<sup>106</sup> The input and oversight of Recofa, in turn, limited the need for legislative intervention.<sup>107</sup> That said, in 2008, many of the procedures that had been standardized as a matter of practice were specifically incorporated into legislative amendments.<sup>108</sup> These changes helped further streamline an already smooth process for consumers.<sup>109</sup> These amendments also brought new relief to the neediest consumers, allowing them to obtain a discharge after a year if the trustee believes that further proceedings would not be justified.<sup>110</sup> According to Professor Kilborn, this last development may be evidence of a “fundamental

98. *See id.*

99. *See* Kilborn, *supra* note 47, at 94.

100. *See* Jungmann & Huls, *supra* note 93, at 424. The Code of Conduct was originally promulgated by municipal banks in 1979 and was revised in 2000 to better reflect the goals of WSNP. *Id.* at 431. Although the Code of Conduct is not mandatory, the 2000 changes created a mechanism to hold debt counselling services accountable. *Id.*

101. *Id.* at 424. Approximately ten percent of plan payments go to the counselling service. *Id.*

102. *See* Kilborn, *supra* note 47, at 95.

103. *Id.* at 97.

104. *Id.* at 102–03.

105. *Id.* at 104–05.

106. *See id.* at 99.

107. *See id.* at 99–101.

108. *See* Kilborn, *supra* note 45, at 13–14.

109. *See id.* at 14.

110. *See* Kilborn, *supra* note 5, at 326–27.

reevaluation” of the wisdom of forcing debtors to ensure a lengthy discharge process in order to demonstrate that they have earned their discharge.<sup>111</sup>

The new process provides a necessary safety valve for Dutch consumers struggling with debt.<sup>112</sup> Although consumers initially appeared hesitant to use the new provisions, filings began to rise in the early 2000s.<sup>113</sup> However, the increased popularity of the process left consumer debt agencies struggling to keep up with the pre-filing counseling requirement.<sup>114</sup> This in turn introduced a delay into the system, usually totaling between three and nine months.<sup>115</sup> In addition, once in the system, debtors faced considerable creditor holdout problems, with creditors often taking four or five months to respond to proposals.<sup>116</sup>

The end result was the opposite of what WSNP was intended to achieve: the total number of voluntary debt settlements decreased, even in the face of dramatic increases in the number of debtors applying for relief.<sup>117</sup> Meanwhile, greater numbers of debtors were taking advantage of the court proceedings for statutory debt settlements.<sup>118</sup>

The popularity of the court option led to calls for reform due to perceived abuse.<sup>119</sup> Among other things, the courts were displeased by the inefficiencies that had been created by funneling so many struggling debtors through time-consuming proceedings.<sup>120</sup> In response, lawmakers added a carrot to encourage consumers to attempt to pursue out-of-court workouts with their creditors.<sup>121</sup> The 2008 reforms also created a bit of a stick, adding a provision that gave judges discretion to reject the applications of debtors who did not appear ready to commit to the multi-year process of improving their financial well-being.<sup>122</sup> Applications dropped shortly after these

111. *See id.* at 327.

112. *See* Kilborn, *supra* note 47, at 108. Professor Kilborn notes, however, that the availability of this form of relief likely undermined the will of parties on both sides to go through the credit counseling process in good faith. *See id.* at 94–95.

113. *Id.* at 108; *see also* Jungmann & Huls, *supra* note 93, at 426 chart 20.2.

114. *See* Kilborn, *supra* note 47, at 94.

115. *Id.*

116. *See* Jungmann & Huls, *supra* note 93, at 424 (noting that creditors often took four or five months to respond to debtor proposals, which meant the debtor usually had to wait six to nine months for an accepted plan).

117. *See id.* at 426 chart 20.2.

118. *See id.* at 427 chart 20.1.

119. *See* Kilborn, *supra* note 45, at 13.

120. *See* Jungmann & Huls, *supra* note 93, at 428.

121. *See* Kilborn, *supra* note 45, at 15–16.

122. *Id.* at 14. For example, judges were encouraged to divert homeless debtors or those with drug addictions until their financial issues were better controlled. *Id.*

changes.<sup>123</sup> However, the 2008 reforms do not seem to have put a long-term damper on consumer debtors, with applications quickly returning to pre-reform levels.<sup>124</sup> Nor do the changes appear to have negatively affected consumer access to proceedings, with the rate of acceptance remaining fairly stable at eighty-five percent, comparable to pre-reform rates.<sup>125</sup>

The distortions apparent in the implementation of WSNP center primarily on the debt counselling services. However, the causes of the distortions were quite diffuse and came from sources largely external to the debt counselling services. One significant distortion relates to a design issue that, perhaps inadvertently, led to greater creditor payouts in court-ordered plans. Specifically, WSNP imposes a small administrative surcharge on court-imposed settlements.<sup>126</sup> This surcharge was intended to induce creditors to agree to voluntary plans by ensuring that the total payouts under voluntary plans would be more generous than the payouts under court-imposed settlements.<sup>127</sup> However, according to Jungmann and Huls, in setting the amount of the administrative charge, the legislature failed to account for the typical surcharges imposed by debt counselling services.<sup>128</sup> As a result, voluntary agreements are only more attractive to creditors in smaller cases.<sup>129</sup> For larger cases (involving monthly payments of more than 500 euros), it is more beneficial for creditors to opt for the administrative surcharge that accompanies a court-imposed plan.<sup>130</sup>

In another blow to voluntary agreements, WSNP undermined the tools that debt counselling services had previously relied upon to gain creditor assent. For example, under WSNP, debt counselling services lost their previous leverage of being able to propose payment plans longer than three years.<sup>131</sup> This is because once debtors were empowered by the availability of a statutory alternative, they were less willing to agree to concessions beyond what

123. *See id.* (noting that filings dropped from a high of 18,500 to around 11,000 in 2008 and 12,500 in 2009).

124. *See id.*

125. *See id.*

126. *See Jungmann & Huls, supra* note 93, at 437. Apparently, the Dutch legislature failed to take these payments into account when designing WSNP, as they believed that an administrative surcharge on court-ordered plans would by definition make them less desirable than voluntary solutions.

127. *See id.*

128. *See id.*

129. *See id.*

130. Although Jungmann and Huls believe that the surcharge is flawed, in that it creates greater creditor returns for court-ordered plans involving larger monthly payouts, this could also have been an intentional design feature to attempt to reduce court workloads and limit court involvement to larger cases. *See id.* at 428 (noting that the courts were unhappy about the legally uninteresting workload created by WSNP cases as well as the unsuccessful outcomes for ordinary debtors).

131. *See id.*



they could achieve in court.<sup>132</sup> In addition, WSNP largely ended the long tradition of municipalities stepping in to guarantee consumer plans or fund them on an emergency basis.<sup>133</sup> The availability of municipal funds to bridge critical gaps in payments had previously helped increase the likelihood of successful voluntary plans.<sup>134</sup> However, because WSNP offered struggling debtors a new, alternative safety valve of a court proceeding, municipalities were no longer willing to play a role in bringing reluctant creditors to the negotiating table.<sup>135</sup>

Finally, changes to the Code of Conduct intended to better reflect the goals of WSNP also limited the discretion of debt counselling services. For example, various provisions of the Code were rephrased using mandatory language such as “always” and “only” and deleting open-ended language such as “in principle” and “roughly.”<sup>136</sup> That said, it’s not clear that the Code of Conduct had an immediate impact, because debt counsellors often found ways to work around its provisions.<sup>137</sup> Individual debt counselors reported that they deviated from the Code because of heavy workloads and their personal view that their role was to help as many debtors as possible.<sup>138</sup> Notably, in their willingness to deviate from the Code, debt counselling services may have exacerbated the creditor holdout problems by proposing plans that treated frequent holdouts more favorably than other creditors.<sup>139</sup> Over the long term, this seems to have undermined overall success rates, with creditors reporting that they preferred court-ordered settlements because they trusted the courts to deliver a better result than the debt counselling services.<sup>140</sup>

Eventually, though, the debt counselling services adjusted to their new role in partnership with the courts, with the success rates of voluntary plans climbing toward pre-WSNP rates following the 2008 reforms.<sup>141</sup> Notably,

132. *See id.*

133. *See id.*

134. *See id.*

135. *See id.*

136. *See id.* at 431–32, 432 tbl.20.1.

137. *See id.* at 433.

138. *See id.*

139. *See id.* at 424 n.8.

140. *See id.* at 429. Creditors preferences for court-ordered procedures may also have been due to the lower administrative surcharge in larger cases, as compared to the costs paid to debt counselors. *See id.* at 437. In addition, some creditors report that they see the increased debtor burdens that arise with a court-imposed plan—such as administrative supervision and the public nature of the proceedings—as a necessary punishment for consumers who have taken on too much debt. *Id.* at 438.

141. *Compare* Kilborn, *supra* note 45, at 16 (noting that the rate climbed from twenty-two percent in 2007, to thirty-four percent in 2008, to thirty-eight percent in 2009), *with* Jungmann & Huls, *supra*

these successes may not be due entirely to legal reform; instead, the credit counseling services have acted unilaterally to do a better job triaging cases by putting a greater focus on cases in which an out-of-court negotiation would offer the most realistic solution.<sup>142</sup> However, these successes may also be related to the eventual acceptance of the Code of Conduct and, particularly, its shift from a system of discretionary relief to a more bureaucratic approach.<sup>143</sup> This approach is more efficient from a funding perspective, because the costs incurred by the debt counselling services are subsidized through a surcharge on plan payments of approximately ten percent.<sup>144</sup> In contrast, spending resources on cases in which voluntary settlement is not realistic was a clear example of irrational sorting.

The returned success of voluntary plans is also a welcome development for the courts, whose judges were not pleased that their perceived neutrality, as compared to the debt counselling services, was greatly increasing their workloads with largely uninteresting matters.<sup>145</sup>

Applying the lens of historical institutionalism, WSNP created a unique interplay between the two institutional actors tasked with implementation: the entrenched debt counselling systems and the newly added court system. As gaps quickly emerged between design and implementation, pressure from the courts resulted in repeated legislative action to prevent drifting. These reforms, which include both layering and course-correction, required the debt counselling systems to adapt and adjust to a new institutional role. Like the French commissions, the Netherlands' debt counselling services were somewhat slow to embrace these new institutional mandates. However, over time, the debt counsellors have adjusted to their new roles, which in turn has led to fewer sorting problems and improved consumer outcomes.

### *B. Conversion Leading to Negative Outcomes*

In this Part, I look to the examples of three countries that show evidence of conversion. In each case, the conversion is accompanied by new sorting problems, increased costs to consumers, fewer options for consumers, or some combination of these three negative outcomes.

note 93, at 420 (noting that the rates dropped from forty percent at the time WSNP was enacted to ten percent in 2004).

142. See Kilborn, *supra* note 45, at 16.

143. See Jungmann & Huls, *supra* note 93, at 433.

144. See *id.* at 424. Typical payments range from nine percent to fourteen percent. *Id.* at 437.

145. See *id.* at 439.

### 1. Scotland

One of the most striking examples of conversion in an insolvency system is Scotland. Overindebted Scottish consumers may avail themselves of a process called “sequestration,” in which a trustee oversees a process that automatically leads to a discharge after three years.<sup>146</sup> Alternatively, consumers can arrange for repayment of individual creditors using private and protected trust deeds.<sup>147</sup>

Although similar forms of debt relief had been available since 1913, Scottish consumers rarely availed themselves of bankruptcy proceedings.<sup>148</sup> Insufficient practitioner incentives seem to have been the main hurdle: a bankruptcy required a private trustee, but practitioners were reluctant to serve in this role unless there were promising prospects for payments—either in the form of estate assets or third-party guarantee.<sup>149</sup> A 1985 redesign was undertaken in part to respond to the access-to-justice problems created by a system that depended on professional incentives.<sup>150</sup>

The Scottish government addressed the access-to-justice problems by providing trustee funding in cases in which the debtor would not otherwise be able to afford professional assistance.<sup>151</sup> But this shift worked too well: practitioners quickly found a way to exploit the system, steering clients into sequestration and then securing their own appointment as trustee, sometimes with the aid of a friendly creditor.<sup>152</sup> As a result, the number of sequestrations ballooned between 1985 and 1993, as did the amounts that the Scottish government had to pay to the now over-incentivized trustees.<sup>153</sup> Indeed, the best evidence that Scottish attorneys were exploiting an ambiguity in the system is the fact that government payments to trustees increased by a factor of 2000 over an eight-year period, rising from £13,000 in 1986–1987 to £26.31 million in 1993.<sup>154</sup>

146. See ZIEGEL, *supra* note 2, at 129.

147. See *id.*

148. See *id.* at 131.

149. See *id.*

150. See *id.*

151. See *id.*

152. See *id.*

153. See *id.*

154. See *id.* (citing ACCOUNTANT IN BANKR., ANNUAL REPORT FOR THE YEAR ENDED 31 MARCH 1998, at 23 tbl.(vi) (1998) (Scot.)).

This dramatic rise in government spending provoked three reforms. First, the government changed the trustee payment system into block payments, which basically halved the fees payable for individual cases.<sup>155</sup> Second, for the majority of cases, the private trustee was replaced by a government official known as the “Accountant in Bankruptcy.”<sup>156</sup> Third, the insolvency laws were amended to reduce the ability of a trustee to bring a sequestration without creditor or court approval.<sup>157</sup>

These reforms resulted in a sudden drop in the number of sequestrations brought on behalf of Scottish consumers.<sup>158</sup> While some might contend that this was merely rightsizing an out-of-control system, others believed that the changes prevented consumers in need from accessing debt relief.<sup>159</sup> As was the case in 1985, Scottish lawmakers once again found themselves faced with various proposals to expand access,<sup>160</sup> prompting an ongoing series of smaller reforms beginning in 2002.<sup>161</sup>

The late twentieth-century evolution of the Scottish consumer insolvency system reflects Scotland’s legal culture, at least to some degree. Scotland legal practice has long been “a cosy gentleman’s club” that shuns outsiders and reflects a strong sense of professional privilege.<sup>162</sup> In addition, the country’s legal system has historically drawn from a wide range of influences, picking and choosing what suits it while endeavoring to maintain its distinctiveness.<sup>163</sup> One practitioner proudly referred to the legal system, somewhat cryptically, as “inundated with pragmatic solutions and common law.”<sup>164</sup> It is therefore not surprising that Scotland’s legal culture would adopt unique and untested elements for its insolvency law. Nor is it surprising that the Scottish insolvency system would experience conversion, with private practitioners exploiting ambiguities in the existing legal framework.<sup>165</sup>

155. *See id.* at 132.

156. *See id.* at 131–32.

157. *See id.* at 132 (describing the changes resulting from the 1993 Amending Act, Bankruptcy (Scotland) Act 1993, ch. 6).

158. *See id.*

159. *See id.* at 132–33.

160. *See id.* at 133.

161. *See RAMSAY, supra* note 24, at 4 tbl. 1.1.

162. *See* Esin Öricü, *The Judge and Jurist in Scotland: On the Verge of a Second Renaissance*, 78 TUL. L. REV. 89, 96 (2003).

163. *See id.* at 92.

164. *See* Sarah Meck, *An Independent Scottish Legal Market Brims with Opportunities for Global Players*, OF COUNSEL, July 3, 2000, at 1, 9.

165. *See* Öricü, *supra* note 162, at 96 (noting the tension in Scottish law between “avoid[ing] the danger of self-referential development” and not allowing its “status as a mixed jurisdiction [to] ‘dictate’” the available options for legal development).

## 2. United States

The United States presents an interesting example of a system that started out quite consumer-friendly, with lawyers and courts as central institutions, but has become less consumer-friendly over time. The role of lawyers in shaping the U.S. system has been the subject of significant scholarly interest. For example, Professor David Skeel has analyzed the role of lawyers in shaping the 1978 Bankruptcy Code.<sup>166</sup> Seminal articles by Professor Jean Braucher and Professors Teresa Sullivan, Elizabeth Warren, and Jay Westbrook have explored the ways in which local legal cultures have influenced the implementation of the 1978 Code here in the United States.<sup>167</sup> More recently, Professor Angela Littwin has offered a strong defense of the role of the private bar in the United States' system.<sup>168</sup> She points to the private bar's success in obtaining discharges for their clients, particularly as compared to unrepresented consumers.<sup>169</sup> Littwin argues that lawyers play a vital role in maintaining a functioning bankruptcy system in the United States, especially in the face of the overall societal trend toward cutbacks to social welfare programs.<sup>170</sup>

The changes in the United States' consumer insolvency system have been the subject of much study, but the discussion below will only address the key points that are most significant to a historical institutionalism analysis.

With the 1978 Bankruptcy Reform Act, the United States made the groundbreaking decision to provide a fairly straightforward discharge option to consumers under chapter 7. Chapter 7 allowed consumers a relatively quick and low-cost discharge in exchange for the liquidation of their assets, which in turn was subject to exemptions that were, in many cases, quite generous. As an alternative to relief under chapter 7, consumers were also free to choose the option of a long-term payment plan under chapter 13, followed by a discharge without the need for liquidation of assets. The dual system

166. See DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 146–51 (2001) (discussing the bankruptcy bar's self-interested advocacy for scope-expanding provisions in the 1978 Bankruptcy Code).

167. See generally Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993); Teresa Sullivan et al., *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994).

168. See Littwin, *supra* note 11, at 1935 (noting that lawyers play a protective role in the system).

169. See *id.* at 1971–72 (finding that 17.6 percent of debtors who file for chapter 7 without representation have their cases dismissed, as compared to 1.9 percent of debtors who have attorneys).

170. See *id.* at 2009–22.

included several “carrots” that would encourage consumers to repay more debt over a longer term using chapter 13.<sup>171</sup>

Chapter 7 proved quite popular.<sup>172</sup> Due in part to the high rates of use, and concerns of abuse, Congress scaled back consumer options in 2005, with the Bankruptcy Abuse Prevention and Consumer Protection Act. The carrots that were intended to encourage consumers to file for chapter 13 were largely eliminated and instead replaced with sticks to force consumers into chapter 13: most notably, the “Means Test,” which required every filer to submit to a “time- and resource-intensive” process that ostensibly prevents higher income consumers from pursuing relief under chapter 7.<sup>173</sup>

Lawyers played a key role in the design of the 1978 system.<sup>174</sup> In particular, lawyers (along with the federal judiciary) opposed proposals to create an administrative system that would provide easy relief for consumers with no assets.<sup>175</sup> Instead, they favored a judicial model, which in turn cemented their institutional role in the implementation of the system.

In stark contrast to their key role in 1978, lawyers were largely excluded from the design of the 2005 amendments.<sup>176</sup> These amendments dampened filing rates, because chapter 7 became less accessible and chapter 13 became less desirable.<sup>177</sup> In addition, the 2005 changes shifted the U.S. system ever

171. See RAMSAY, *supra* note 24, at 49 (noting in particular the chapter 13 debtor’s ability to change payment terms to secured creditors (known as “cramdown”) and to discharge several categories of debts not dischargeable in chapter 7 (known as the “super discharge”).

172. See Kilborn, *supra* note 45, at 3 (positing that reform efforts were spurred in part by the fact that in 1996, “annual bankruptcy filings had exceeded the psychologically important one million mark”).

173. See *generally id.* at 6–9 (explaining how the Means Test works).

174. See SKEEL, *supra* note 166, at 150 (noting “the bankruptcy bar’s remarkable success in expanding the scope of U.S. bankruptcy laws” through the enactment of the 1978 Code); Littwin, *supra* note 11, at 1984–85.

175. See Ramsay, *supra* note 4, at 271.

176. As Professor Skeel explains it, the credit industry sought to preempt pro-consumer reform efforts by submitting their own legislation. See SKEEL, *supra* note 166, at 187–88. Although the credit industry’s proposals were embraced by the Republican-dominated Congress, *id.* at 199, President Clinton ultimately refused to sign the bill into law. *Id.* at 210. The 2005 amendments that were ultimately signed into law by President George W. Bush were written by credit card issuer MBNA and passed with little input from the professionals who would be tasked with implementing them. See Kilborn, *supra* note 45, at 4; see also Ramsay, *supra* note 4, at 264 (noting that the fact that BAPCPA was enacted over the objection of many bankruptcy professionals “indicates the limits of professional influence over legislation (if not over its implementation)”).

177. Filings dropped initially but returned to pre-BAPCPA levels of well over one million filings within five years. See Kilborn, *supra* note 45, at 4. However, this surge also coincided with the foreclosure crisis, when many homeowners were using bankruptcy protections to try to save their homes. Levels have dropped off significantly in recent years, with approximately 750,000 consumer filings in 2016. See *2016 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, U.S. COURTS, <http://www.uscourts.gov/statistics-reports/bapcpa-report-2016> [perma.cc/63ER-RNEW].

so slightly away from a broadly discretionary model and towards a more bureaucratic model, with the introduction of more bright line rules such as the Means Test.<sup>178</sup>

These changes were decidedly not pro-consumer.<sup>179</sup> Clear evidence of this comes from the increased costs to file bankruptcy, which puts bankruptcy out of reach for many low-income families.<sup>180</sup> Although consumers can attempt to reduce costs by filing without legal representation, this dramatically reduces the odds of receiving a discharge.<sup>181</sup> This presents a dilemma for consumers who want representation but cannot afford the upfront fees necessary to file for bankruptcy.

One imperfect solution to this dilemma is to file a so-called “fee-only” chapter 13, a term used to describe a chapter 13 plan in which the majority of plan payments go toward attorney fees.<sup>182</sup> A recent article highlights the rise of this controversial practice.<sup>183</sup> Specifically, Professors Foohey, Lawless, Porter, and Thorne demonstrate that the number of fee-only chapter 13 filings has increased significantly since 2007, while the number of consumers filing chapter 7 and traditional chapter 13 have declined.<sup>184</sup> They trace these developments to a number of factors, including the U.S. Supreme Court’s decision in *Lamie v. United States Trustee*.<sup>185</sup> In *Lamie*, the Supreme Court concluded that only an attorney who is under the supervision of a trustee can be paid with funds from the bankruptcy estate.<sup>186</sup> Thus, consumer attorneys found themselves with no viable way to ensure payment from a chapter 7 client who needed to file for bankruptcy quickly but lacked the funds to pay attorney fees up front.<sup>187</sup>

178. See generally Kilborn, *supra* note 45, at 6–9.

179. See, e.g., *id.* at 5 (arguing that BAPCPA “created a mass of expensive, burdensome, and distracting challenges for debtors, their lawyers, trustees, and the courts”).

180. See Michelle J. White, *Bankruptcy Reform and Credit Cards*, J. ECON. PERSP., Fall 2007, at 175, 187 (noting increased out of pockets costs for debtors post-BAPCPA); see also Mann, *supra* note 3, at 242 (“[I]t is surprising that the US has not yet come to grips with the reality of the lower-middle-class bankrupt who has no substantial income or assets.”).

181. See Littwin, *supra* note 11, at 1971–72 (noting that pro se debtors have close to nine times the dismissal rate as debtors with attorney representation).

182. See Pamela Foohey, Robert M. Lawless, Katherine Porter & Deborah Thorne, “No Money Down” *Bankruptcy*, 90 S. CAL. L. REV. 1055, 1104 (2017).

183. See Paul Kiel with Hannah Fresques, *How the Bankruptcy System Is Failing Black Americans*, PROPUBLICA (Sept. 27, 2017), <https://features.propublica.org/bankruptcy-inequality/bankruptcy-failing-black-americans-debt-chapter-13/> [<https://perma.cc/6FG3-2GH4>].

184. Foohey et al., *supra* note 182, at 1075 tbl.1.

185. 540 U.S. 526, 529 (2004).

186. *Id.*

187. Foohey et al., *supra* note 182, at 1066–68. While there is no ethical way to ensure payment under these circumstances, Foohey et al. note that some attorneys will accept post-dated checks, which arguably violates either the automatic stay or the discharge injunction. *Id.* at 1067–68.

Accordingly, attorneys have increasingly turned to chapter 13 as a way of ensuring payment from clients and facilitating their access to the protections of bankruptcy court. Notably, the costs and fees a consumer must pay over the course of a chapter 13 are, on average, almost \$2000 higher than the costs and fees of a chapter 7.<sup>188</sup>

Professors Foohey et al. argue that this trend toward fee-only chapter 13 is evidence that practitioner incentives are affecting the use and accessibility of chapter 7. Their argument is bolstered by findings from a separate consumer study conducted by Lois Lupica, which showed that bankruptcy practitioners were losing money on chapter 7 practices.<sup>189</sup> They propose both legislative and judicial fixes in order to ensure that consumers have equal access to bankruptcy and do not have their options limited by attorney incentives.<sup>190</sup>

Assuming that the critiques of fee-only chapter 13s are correct,<sup>191</sup> the increased use of this mechanism may represent an example of conversion, with institutional actors (here, private attorneys) exploiting ambiguities in the system by steering clients toward chapter 13 in order to generate greater fee revenues from clients who would be better served by chapter 7. Moreover, attorneys who indiscriminately steer clients toward chapter 13 rather than chapter 7 contribute to irrational sorting problems, in that courts are forced to spend increased time confirming or modifying chapter 13 plans for debtors who would be better served by a quick and simple chapter 7 discharge. It remains to be seen how Congress and the courts will respond to the current calls for reform. A lack of response may be seen as an example of drifting, which leads to the follow up question of whether the drifting is inadvertent or intentional. Intentional drifting could indicate that the politically difficult goal of further reducing access to a chapter 7 discharge is being achieved through institutional means.<sup>192</sup>

188. *Id.* at 1058 (finding average fees of \$1229 for chapter 7 and \$3217 for chapter 13).

189. *Id.* (citing Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 AM. BANKR. INST. L. REV. 17, 30, 69 (2012)).

190. *Id.* at 1102–05.

191. Courts have had a mixed reaction to fee-only chapter 13. Compare *Berliner v. Pappalardo* (*In re Puffer*), 674 F.3d 78, 83 (1st Cir. 2012) (“The dangers of such plans are manifest, and a debtor who submits such a plan carries a heavy burden of demonstrating special circumstances that justify its submission.”), with *In re Doucet*, No. 15-21531, 2016 WL 2603072, at \*8 (Bankr. D. Kan. May 3, 2016) (“Courts fear attorneys choose Chapter 13 instead of Chapter 7 to secure higher fees and win the client when they cannot otherwise afford Chapter 7’s upfront costs. This view is misplaced . . .”). There are certainly instances in which chapter 13 is the only viable option for a client who needs immediate relief and cannot afford the up-front fees of chapter 7.

192. The theory of intentional drift is bolstered by the critique that the introduction of the Means Test in 2005 was more symbolic than meaningful. See SKEEL, *supra* note 166, at 205 (questioning why the credit industry was “so anxious to enact a provision with so little real bite”). The fact that the Code is



The critiques of the U.S. insolvency system parallel the problems that have been identified in our civil litigation system. In particular, high attorney fees are a hallmark of our civil system.<sup>193</sup> High fees relate largely to lawyers' monopoly power as well as the barriers to entering the profession.<sup>194</sup> The effect of these barriers is likely magnified for debtors in light of the highly technical nature of bankruptcy law.<sup>195</sup>

### 3. Canada

A third example of conversion and drifting comes from the Canadian experience, where consumer insolvency law underwent repeated adjustments to address practitioner incentives. In Canada, debtors have the option of pursuing a straightforward bankruptcy with a discharge or making a consumer proposal, which requires the debtor to make more payments to creditors.<sup>196</sup>

There are two key actors in Canadian consumer bankruptcies: the Office of the Superintendent of Bankruptcy (OSB), which oversees administration,<sup>197</sup> and the trustee, who is a private practitioner with an accounting background.<sup>198</sup> Canadian trustees have a monopoly on consumer debt proceedings, even more so than lawyers in the United States, because a private trustee is essential to the consumer process in Canada.<sup>199</sup> Importantly, trustees were not always this powerful: Canada used to offer a popular, publicly administered option in the 1970s.<sup>200</sup> However, the public option was abolished in 1979 after lobbying from the trustee industry.<sup>201</sup>

From there, the trustee's role was centralized and expanded in 1991.<sup>202</sup> In addition to their longstanding duty to report on the debtor's reasons for filing,<sup>203</sup> trustees were newly charged with determining the debtor's "surplus income," meaning the amount available to be paid to creditors.<sup>204</sup> This

already forcing high-income debtors into chapter 13 makes it a bit harder to highlight the inequity that arises from the structural incentives facing low-income debtors.

193. See, e.g., Gillian Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953, 954 (2000).

194. *Id.* at 982–84.

195. See Littwin, *supra* note 11, at 1938.

196. See Ramsay, *supra* note 40, at 385–86.

197. See *id.* at 393–94.

198. See *id.* at 387.

199. See *id.*

200. See *id.* at 388.

201. See *id.*

202. See ZIEGEL, *supra* note 2, at 28–30.

203. See *id.* at 38–39.

204. See *id.* at 29–30.

amount is typically fifty to seventy-five percent of the amount remaining after payment of the debtor's basic living expenses.<sup>205</sup> Trustees were also tasked with monitoring the debtor's compliance in order to make a recommendation on whether remaining debt should be discharged, or whether the debtor is capable of making continued payments.<sup>206</sup>

One notable flaw in the design of this system is that trustees are private practitioners who are hired by the debtor.<sup>207</sup> Practitioners advertise heavily to attract this business, which in turn creates a risk of a conflict of interest.<sup>208</sup> In particular, Professor Ziegel expressed concern that debtors might feel misled by hiring a professional who will later make recommendations as a trustee that complicate the path to discharge. Alternatively, perhaps the close relationship between debtor and trustee might interfere with the trustee's recommendations regarding discharge.<sup>209</sup> Although Ziegel admits there is "no hard evidence" of an actual conflict,<sup>210</sup> he notes that trustees reported feeling pressure from debtors. This pressure may have affected performance, because recommendations for continued payments in lieu of discharge were quite rare.<sup>211</sup>

On the other hand, there is hard evidence of other instances of conversion that results in increased costs for consumers as well as irrational sorting among debtors. For example, the majority of disbursements go to pay the trustee, rather than creditors.<sup>212</sup> In addition, these fees come at the expense of debtors, who end up paying more than they otherwise need to in order to compensate their trustees.<sup>213</sup> Another distortion that has been identified is that married debtors do not appear to be taking advantage of the process for filing joint petitions, a reform that was introduced in 1992 to create cost savings for consumers.<sup>214</sup> This failure to realize the benefits of reform may be due to trustees' incentives to undercut the law on the books.<sup>215</sup> Moreover, the OSB appears to have practically partnered with the trustees to create drifting

205. *See id.*

206. *See id.* at 37.

207. *See id.* at 155.

208. *See id.*; Ramsay, *supra* note 40, at 389 (noting that the competition for business may lead to "'unfair competition' from . . . those willing to provide a pro-debtor interpretation of legislation").

209. *See* ZIEGEL, *supra* note 2, at 155–56.

210. *See id.* at 155.

211. *See id.* at 37 (noting that trustees recommended extended payments in approximately seven percent of cases).

212. *See* Braucher, *supra* note 41, at 339–40 (noting that a 2001 study showed that trustees received four times the disbursements that creditors received).

213. *See id.* at 339 (noting that a 2005 study showed that forty-five percent of debtors with surplus income liability paid additional amounts to their trustee, averaging \$1800 over a nine-month period).

214. *See* Ramsay, *supra* note 40, at 389–90.

215. *See id.* at 389.

in the system, by raising the fees that trustees could charge for consumer proposals.<sup>216</sup> As a result, trustees may be hesitant to recommend the less lucrative option of bankruptcy, which in turn has produced the intended result of reducing the numbers of consumers filing for bankruptcy.<sup>217</sup> This may exacerbate sorting problems and lead to suboptimal outcomes for consumers.<sup>218</sup>

### *C. Countries that Have Been Slower to Address Drifting*

The third set of examples are systems in which inadequate practitioner incentives and an absence of strong institutional change agents creates distortions that have not been effectively addressed by lawmakers, which has led to drifting.

#### *1. Germany*

The first example of an insolvency system in which inadequate incentives may be impeding policy objectives comes from Germany. Unlike Scotland, which created too much practitioner interest in sequestrations,<sup>219</sup> the German government's efforts to extend debt relief to consumers was thwarted by the insufficient incentives for practitioners to take on bankruptcy cases.<sup>220</sup> German insolvency law traditionally did not distinguish between business and consumer bankruptcy,<sup>221</sup> and no court-ordered discharge was available to either type of debtor.<sup>222</sup> The main mechanism for debt relief was a procedure for court-ordered settlement that was based on negotiations with creditors.<sup>223</sup>

However, while the system was adequate for businesses, its provisions were not favorable to consumers.<sup>224</sup> Among other problems, a debtor could only use the court-ordered liquidation process if there were enough assets available to cover the costs of the proceeding.<sup>225</sup> Because these costs were

216. *See id.* at 410.

217. *See id.*

218. *See id.* at 411.

219. *See supra* Section I.B.1.

220. *See generally* ZIEGEL, *supra* note 2, at 140–43.

221. *See* Jason J. Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States*, 24 NW. J. INT'L L. & BUS. 257, 262 (2004).

222. *See id.* at 264.

223. *See id.* at 262–63 (describing Germany's two pre-1999 alternatives: *Konkursordnung*, which had a liquidation provision, and *Vergleichsordnung*, which was more of a restructuring provision).

224. *Id.* at 262.

225. *See id.* at 263.

significant, most debtors who entered these proceedings found their cases dismissed for insufficient assets.<sup>226</sup>

After reunification, German lawmakers began to focus on reforming the country's insolvency laws, with an eye towards creating a discharge mechanism for businesses.<sup>227</sup> However, Germany was also facing a rising consumer debt crisis in the 1980s and 1990s.<sup>228</sup> Under pressure from consumer groups and the Social Democratic party, lawmakers added provisions that were intended to expand relief to consumers.<sup>229</sup>

The new law, *Insolvenzordnung*, was enacted in 1994 but became effective in 1999.<sup>230</sup> It provided for a debt adjustment procedure in which consumers would negotiate with creditors for a repayment plan, which would be binding on unsecured creditors based on the approval of half the creditors (in both number and value).<sup>231</sup> It also provided for a bankruptcy proceeding in which consumers committed to a seven year payment plan, followed by a discharge of remaining debt if they satisfied all of the statutory requirements.<sup>232</sup>

The law quickly proved ineffective, with only thirteen percent of applications leading to approved payment plans.<sup>233</sup> Among other things, the procedures were quite complex, and the prospect of low fees made attorneys reluctant to take on cases.<sup>234</sup> The 1994 *Insolvenzordnung* was amended less than two years after taking effect in an effort to better incentivize consumer filings.<sup>235</sup> Most of the reforms were substantive, including a reduction in the commitment period (a decrease from seven years, running from the date of approval, to six years, running from the filing date).<sup>236</sup> The amendments also helped expand access to lower-income debtors by reducing court fees and allowing some debtors the option of postponing payment until after discharge.<sup>237</sup> The *Insolvenzordnung* also has a unique feature of "motivation rebates," which allows debtors to retain more of their income after they have

226. *Id.*

227. See ZIEGEL, *supra* note 2, at 140.

228. See Kilborn, *supra* note 221, at 260–61.

229. See ZIEGEL, *supra* note 2, at 140.

230. See *id.* at 140–41.

231. See *id.* at 141 (describing the procedures under article 304 of the 1994 *Insolvenzordnung*).

232. See *id.* (describing article 286 of the 1994 *Insolvenzordnung*).

233. See *id.*

234. See *id.*

235. See *id.* at 142.

236. See *id.*

237. See *id.*; see also Wolfram Backert et al., *Bankruptcy in Germany: Filing Rates and the People Behind the Numbers*, in CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES, *supra* note 3, at 273, 274.

made four years of payments.<sup>238</sup> The amendments that took effect in 2002 expanded the amount of income that consumer debtors are allowed to retain through proceedings, subject to periodic review for inflation.<sup>239</sup> Although the amounts that consumers retain are not large, they created “a much more solid foundation for a modest lifestyle.”<sup>240</sup> Consumer filings increased exponentially after these amendments,<sup>241</sup> with rates rising steadily for several years, until dropping for the first time in 2008.<sup>242</sup>

Despite these efforts to make consumer insolvency proceedings more debtor-friendly, it is still not clear that Germany has created the right incentives to optimally address its consumer debt problem.<sup>243</sup> Lawyers are unwilling to take on consumer cases because the pay is inadequate to compensate for the amount of work involved in navigating the complicated procedures.<sup>244</sup> Without private attorneys, the task of assisting overindebted consumers with bankruptcy falls entirely to government-funded consumer debt agencies. Professor Kilborn noted “serious bottlenecks in the system,” as there were not sufficient numbers of professionals to meet the demands.<sup>245</sup> The centers are not funded at adequate levels.<sup>246</sup> Waiting periods can be as long as a year, and some centers even had to turn away debtors by the mid-2000s because even their waiting lists became unmanageable.<sup>247</sup> Moreover, in many federal states, these agencies only get paid based on the number of insolvency proceedings they initiate, which may further distort the rate of

238. Kilborn, *supra* note 221, at 283–84. Professor Kilborn explains that these rebates were proposed as an alternative to reducing the length of the payment period to four years, as proposed by the Social Democrats. *Id.* at 283. Instead, after completing the fourth year of payment, consumers receive a ten percent rebate of their annual income assigned to creditors. *Id.* at 284. The rebate increases to fifteen percent in year five and to twenty percent in year six. *Id.* at 283–84.

239. *Id.* at 285–86.

240. *Id.* at 286. According to Professor Kilborn, creditors receive surprisingly little from debtors during the six-year waiting period. *Id.* at 291. This in turn suggests that the waiting period is intended less as a mechanism to improve creditor recovery and more as “a psychological device to press upon the debtor the notion of shouldering the burden of unpaid debts in order to earn the privilege of a discharge.” *Id.* As further support for the paternalistic nature of the system, Professor Kilborn explains that the German word for the six-year payment period (*Wohlverhaltensperiode*) translates as “good behavior period,” which in turn suggests that German insolvency law is intended to promote a “resocialization” of consumer debtors. *Id.* at 296.

241. See Backert et al., *supra* note 237, at 274.

242. See Michael Knobloch, *Unemployment and Overindebtedness in Germany*, in CONTEMPORARY ISSUES IN CONSUMER BANKRUPTCY 127, 142 (Wolfram Backert et al. eds., 2013).

243. See *id.* at 139–40.

244. See Kilborn, *supra* note 221, at 272–73.

245. See *id.* at 273–74.

246. See *id.*

247. *Id.* at 274.

filing.<sup>248</sup> As of 2009, eight out of ten consumers who initiate adjustment proceedings end up filing for bankruptcy.<sup>249</sup>

Studies of the German system show that consumers, on average, postpone seeking assistance until they are well beyond the point of recovery.<sup>250</sup> This suggests that there are still impediments in the design of the system, in that the law is relatively harsh on consumers.<sup>251</sup> For example, the six-year waiting period for a discharge is seen by consumer advocacy groups as overly long, particularly when compared to the shorter periods selected by some other European countries.<sup>252</sup> In addition, the process for obtaining a discharge is seen as overly complex, with one commentator describing it as “a complicated four-step obstacle course.”<sup>253</sup> The one-size-fits-all process suggests that Germany engages in irrational sorting, by forcing all consumers to jump through each hoop in order to earn a discharge, with no corresponding benefit to creditors in most cases.

Although various reform proposals have been brought forward since 2001, political change has been slow to materialize.<sup>254</sup> This lack of legal change appears to be a potent example of drifting. This drifting may stem from the fact that, unlike most of the other countries discussed, Germany lacks a powerful institutional force in its insolvency systems. The courts do not appear to be playing a prominent role in reform efforts, which may reflect the relatively limited degree of public confidence that Germans have in their civil court system.<sup>255</sup> Moreover, the fact that German lawyers do not have incentives to play a prominent role in the system leaves the consumer insolvency system without a powerful institutional force for change, which may further contribute to drifting.

248. See Knobloch, *supra* note 242, at 139–40.

249. See *id.* at 140.

250. See *id.*; see also Backert et al., *supra* note 237, at 281 (finding that the average debtor is lower-income and struggles with employment).

251. See Backert et al., *supra* note 237, at 288 (noting that many of the hurdles in German law unnecessarily burden low income consumers without creating any benefits for creditors).

252. See Kilborn, *supra* note 221, at 284; see also Kilborn, *supra* note 45, at 24 (“[T]he great bulk of cases impose an extended period of pain on debtors and an uncompensated administrative burden on the [federal government] with no obvious corresponding benefit . . .”).

253. Kilborn, *supra* note 221, at 272.

254. See Kilborn, *supra* note 5, at 328 (noting in 2007 that long-pending studies might finally result in reforms); Kilborn, *supra* note 45, at 22 (as of 2012, “a decade has passed since Germany last reformed its consumer insolvency law[s]”).

255. See Peter Gottwald, *Civil Procedure Reform in Germany*, 45 AM. J. COMP. L. 753, 759 (1997) (noting that Germany has an unusually high rate of appeals compared to other European countries, and this lack of confidence may reflect the weak qualifications and experience of its judges).

## 2. Japan

Japanese insolvency law, like many other areas of Japanese law, has undergone gradual and incremental reforms during the last few decades.<sup>256</sup> Japan offers two forms of relief to consumer debtors: a discharge under bankruptcy law as well as a civil rehabilitation proceeding.<sup>257</sup> Consumers have great flexibility to choose either alternative.<sup>258</sup> Rehabilitation proceedings are much more complicated and were largely designed for businesses rather than consumers.<sup>259</sup> Moreover, proceedings are quite lengthy, lasting ten years.<sup>260</sup> At that point, Japanese consumers may apply for a discharge on terms that are fairly similar to the United States.<sup>261</sup> Specifically, the judge must find that the debtor is honest and unable to repay their debt.<sup>262</sup> The sheer cost of these proceedings puts them out of reach for most consumers.<sup>263</sup> These proceedings were streamlined in 2000 to allow certain consumer debtors to obtain a discharge in three years.<sup>264</sup> Despite these changes, the rate of usage of rehabilitation proceedings has remained very low.<sup>265</sup>

In contrast, Japan's bankruptcy option is a straightforward liquidation proceeding: the debtor gives up non-exempt assets, which are then liquidated for pro rata distribution to creditors.<sup>266</sup> If the debtor does not have any non-exempt assets to liquidate, the debtor is eligible for "simultaneous termination," which means that the discharge is granted immediately without the need to appoint a trustee.<sup>267</sup> However, the court may exercise its discretion to appoint a trustee who conducts a limited investigation into whether the

256. See Souichirou Kozuka & Luke Nottage, *The Myth of the Cautious Consumer: Law, Culture, Economics and Politics in the Rise and Partial Fall of Unsecured Lending in Japan*, in CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES, *supra* note 3, at 199, 209.

257. Junichi Matsushita, *Japan's Personal Insolvency Law*, 42 TEX. INT'L L.J. 765, 765 (2007). The Bankruptcy Law (*Hasan Ho*) was amended in 2004 and became effective in 2005, while the rehabilitation provisions (*Minji Saisei Ho*) were enacted in 1999 and became effective in 2000. *Id.* at 766.

258. See *id.* at 769–70 (explaining that the government rejected initial proposals to require rehabilitation if a debtor had significant disposable income or to condition discharge on a debtor's payment of the amount the debtor would be expected to pay under a rehabilitation plan).

259. See *id.* at 768.

260. See Martin, *supra* note 1, at 59.

261. See *id.*

262. See *id.* at 59 n.385.

263. See Matsushita, *supra* note 257, at 768.

264. See *id.* The streamlined procedures are available to debtors with regular income who owe less than 50 million yen. *Id.* (citing MINJI SAISEI HO [Civil Rehabilitation Law] 1999 (Japan)).

265. See *id.* at 769 (noting that there were just over 8000 streamlined rehabilitation cases filed in 2003 and 2004).

266. See *id.* at 766.

267. See *id.* at 767–68.

debtor is concealing assets prior to granting a discharge.<sup>268</sup> As of 2005, close to ninety percent of cases were no asset cases, and trustees were appointed and then terminated in seven percent of these cases.<sup>269</sup>

Japan's bankruptcy law underwent major amendments in 2005, most significantly to dramatically increase the consumer exemption amounts.<sup>270</sup> Although the dollar ceiling for exempt assets is still quite low (the equivalent of less than \$10,000 dollars at the time of enactment), it reflects a more than four-fold increase over the meager pre-2005 limits, which were seen as inadequate to protect debtors and their dependents.<sup>271</sup> The 2005 amendments also reduced the time period for a successive discharge from ten years to seven years, and further authorized courts to waive the waiting period altogether at their discretion.<sup>272</sup> As amended, the bankruptcy option is far more popular among consumers than the rehabilitation option.<sup>273</sup>

Perhaps due in part to these reforms, Japan experienced record numbers of consumer bankruptcies in the latter half of the 2000s.<sup>274</sup> Nonetheless, overall the number of consumers filing for bankruptcy is low relative to countries like the United States.<sup>275</sup> This appears largely due to the great stigma attached to bankruptcy in Japan.<sup>276</sup> The strictly controlled consumer insolvency process appears to both reflect and perpetuate that stigma.<sup>277</sup> Only insolvent consumers are permitted to file a bankruptcy case, meaning that the consumer must be unable to pay debts as they become due.<sup>278</sup> Likewise, the exemptions available to consumers are notoriously skimpy.<sup>279</sup>

268. *See id.* at 768.

269. *See id.*

270. *See id.* at 766.

271. *See id.* at 766 nn.8–9.

272. *See id.* at 767. In exercising its discretion, the court is instructed to consider the reasons for the debtor's financial failure. *Id.* (citing HASAN HO [Bankruptcy Law] 2004 (Japan)).

273. *See id.* at 766 (noting that there are almost ten times as many cases filed under the new bankruptcy law in 2005 as there were rehabilitations).

274. *See* Kozuka & Nottage, *supra* note 256, at 200 (noting that these record filings were accompanied by large numbers of debt-related suicides, with close to twenty percent of unsecured borrowers considered "overindebted" as of 2006); *see also* Ramsay, *supra* note 4, at 269 (Japan's reforms "made insolvency more accessible, and Japan now has a rate higher than England and Wales").

275. *See* Martin, *supra* note 1, at 59 (describing personal bankruptcy as "rare," with only 0.7 filings per 1000 citizens, as compared to 5.2 per thousand in the United States as of 2000).

276. *See id.* at 54 (noting the culture of shame surrounding bankruptcy, that views debt as a personal failure).

277. *See* Kozuka & Nottage, *supra* note 256, at 210 (describing Japan's recent consumer reforms as part of "a tradition of paternalistic protection of the weaker party" that has now been expanded more generally to consumers as a class).

278. *See* Martin, *supra* note 1, at 59.

279. *See id.* at 59–60 (noting that a common expression applied to debtors translates as "one rice bowl and one pair of chopsticks").



That said, the relatively low rate of filing appears to have benefitted those consumers who do decide that they need the relief of a discharge, because the system has fewer gatekeeping requirements.<sup>280</sup> The default is that all debtors who file for bankruptcy will receive a discharge, unless the court exercises its discretion to deny a discharge based on a finding of abuse.<sup>281</sup> In choosing discharge as the default, the 2005 amendments expressly rejected proposals to require higher income debtors to choose rehabilitation, or to require debtors who chose bankruptcy proceedings to pay an amount equivalent to what they would pay in rehabilitation before they could obtain the discharge.<sup>282</sup> In conjunction with the Japanese stigma that deters debtors from filing bankruptcy in the first instance, the legislative decision to impose efficient default rules reduces the risk of irrational sorting and results in a more cost-effective system.<sup>283</sup>

Overall, the Japanese bankruptcy system tends to mirror the civil litigation system. As is reflected in the Japanese word for lawyer—*bengoshi*, which translates as “mediator”—lawyers are expected to serve first and foremost as problem solvers.<sup>284</sup> Courts are only used if absolutely necessary, and it is viewed as “embarrassing and shameful” to be unable to work problems out without the need for court intervention.<sup>285</sup> Just as civil litigants have incentives to try to negotiate solutions rather than resort to courts, Japanese consumers also have incentives to try to negotiate their way to lower debt loads.<sup>286</sup>

Although perhaps not ideal from the perspective of consumers in need of relief, the Japanese system is one that obviously reflects the nation’s cultural values. And, as with Germany, neither the lawyers nor courts appear to be strong proponents of change. Thus, the Japanese insolvency system appears to be another example of drifting.

280. See Matsushita, *supra* note 257, at 770.

281. See *id.* at 771 (noting that there are no clear criteria for determining abuse which means the determination is likely to vary significantly from one judge to the next).

282. See *id.* at 770.

283. See *id.*

284. See Martin, *supra* note 1, at 55–56.

285. See *id.* at 53.

286. See Kozuka & Nottage, *supra* note 256, at 201–02 (explaining that a unique feature of Japanese law regarding interest rates creates a “grey zone” in which a particularly high interest rate may or may not be lawful, and that this grey zone creates many opportunities for lawyers to renegotiate their clients’ debt burdens).

## II. CAPTURING THE ROLE OF PROFESSIONAL AND INSTITUTIONAL ACTORS AS CHANGE AGENTS

This Section discusses some of the main takeaways from the comparative study of the seven consumer insolvency systems discussed in Section I. Part A presents a summary table, and Part B identifies five potential implications that arise from this initial sketch.

### *A. Distilling the Insights Yielded by Historical Institutionalism*

This table provides a broad (and admittedly reductive) overview of the main takeaways from Section I. An explanation of each category follows.

*Table 1: Insights from Historical Institutionalism*

Country	Key Actors	Power as Change Agents	Types of Change	Sorting Problems	Trend
France	Bank of France, high court	Strong	Layering, reform	Improved	Pro-consumer
Netherlands	Debt counselors, courts	Medium	Layering, reform	Improved	Pro-consumer
Scotland	Lawyers	Medium	Conversion, reform	Unchanged	Slightly anti-consumer
United States	Lawyers, courts	Strong	Reform, conversion	Worsened	Anti-consumer
Canada	Accountants, OSB, courts	Medium	Conversion, drifting	Worsened	Moderately anti-consumer

Germany	Debt counsel- lors	Weak	Drifting	Un- changed	Slightly pro-con- sumer
Japan	Lawyers	Weak	Drifting, reform	Improved	Slightly pro-con- sumer

The “Key Actors” column includes the main institutional actors who are tasked with implementing the consumer bankruptcy laws. Although courts play a discernible role in most of these systems, courts are only identified as a key actor if they have played a prominent role in designing the system or shaping its implementation.

The “Power as Change Agents” column is intended to approximate the degree to which the key actors have contributed to change in consumer insolvency systems. Importantly, “change” includes both law on the books and law in action. Thus, for example, an actor like the counselling services in the Netherlands may have little power to change the law on the books, but as the primary actor involved in implementation, these counseling services have a strong law-in-action role. The label assigned is intended to be an aggregate rating.

“Type of Change” includes actual reforms as well as concepts from historical institutionalism that capture the ways in which the law in action may differ from the law on the books.

The column labeled “Sorting Problems” addresses the degree to which recent changes have improved or worsened initial sorting problems in the insolvency system. Importantly, this column is relative to the country’s original baseline and does not reflect a comparison between countries.

Finally, “Trend” addresses whether the changes in the law on the books and the law in action have been pro-consumer or anti-consumer. “Pro-consumer” applies when a country has taken action to expand relief to consumers since 2000. “Anti-consumer” is obviously a loaded term, but it applies when a country has acted to limit consumer options (e.g., the United States and Scotland) or has failed to act in the face of possible conversion that increases the costs consumers must pay for access to debt relief (e.g., the United States and Canada). As with the previous column, the “Trend” reflects changes from a country’s pre-2000 baseline and is not intended as a direct comparison among countries.

### *B. Identifying Patterns*

Although this is just a brief sketch, five interesting points emerge from this table, which may merit further consideration and study. First, we only see instances of conversion in countries where the change agents have private economic incentives. In fact, Japan is the only country where private professionals are key actors but have not shown indications of conversion. This is likely due to the unique nature of the Japanese legal system, as described in Section I.C.2.

Second, conversion is a net negative, both from a consumer perspective and a sorting perspective. In each of the cases in which conversion is observed, the conversion increases irrational sorting, increases the costs to consumers, or both. Notably, when conversion is addressed by reform, as it was in Scotland, the result may still be a net negative for consumers. For example, the legislature may address the perceived abuse by eliminating consumer options that are susceptible to abuse, or by creating obstacles to using these options, which in turn may impose cost or delay on consumers. Importantly, this study did not reveal any instances of countries that have taken steps to impose restrictions on key actors. Instead, the repercussions of reforms to address conversion fall almost entirely on consumers.

Third, strong pro-consumer trends and improved sorting are most often observed in countries without private actors, but with influential change agents. France centered its system around a powerful institutional change agent in the Bank of France, while the Netherlands added the courts as an influential change agent. In both cases, the resulting trends were pro-consumer as well as more efficient in the sense that the resulting changes led to more rational sorting over time.

Fourth, drifting is most likely to occur in countries with relatively weak key actors. Thus, in both Germany and Japan, we see weak actors coupled with some evidence of drifting. This is consistent with the predictions of public choice theory, which tells us that political change is usually driven by powerful and concentrated institutional actors.<sup>287</sup>

Fifth, drifting is not necessarily a negative from the standpoint of consumers or from the standpoint of rational sorting. Japan and Germany both show mixed results from systems that have largely been allowed to drift. This

287. See, e.g., Ramsay, *supra* note 40, at 382 (introducing concepts of interest group analysis and public choice theory to insolvency systems and explaining that particular outcomes are often a “side effect of the interests of more powerful players”).

is consistent with the possibility that drifting (like conversion) may be intentional design feature that allow the institutional actors to facilitate outcomes that could not be achieved directly through political change.

#### CONCLUSION

It is well established that consumer bankruptcy systems are social tools that reflect a country's value system.<sup>288</sup> But once designed, the system is then entrusted to professionals and institutions for implementation. As consumer insolvency law evolves around the world, the varied roles of those professionals and institutions have become clearer and yield a broader understanding of why gaps emerge between design and implementation, and how those gaps can best be addressed. Moreover, the ways in which various countries respond to those gaps are often as important as the initial design choices, if not more so. By taking these additional questions into account, comparative scholars can move toward deeper understandings of insolvency law in action, alongside the already rich body of work addressing the law on the books.

288. See Martin, *supra* note 1, at 5.